RD AN No. 3870 (4279-B)
June 12, 2003

SUBJECT: Business and Industry Guaranteed Loan Program
Percentage of Guarantee

TO: State Directors, Rural Development

ATTN: Business Programs Directors

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance and clarification regarding under what circumstances the Agency approval official should consider proposing a reduced percentage of guarantee to lenders. Examples provided are not to be construed as an exclusive list of situations where less than the maximum percentage of guarantee is more appropriate to protect the interests of the Government.

COMPARISON WITH PREVIOUS AN:

This replaces AN No. 3756 (4279-B), dated May 6, 2002.

IMPLEMENTATION RESPONSIBILITIES:

RD Instruction 4279-B, section 4279.119(b), states in part: “The percentage of guarantee, up to the maximum allowed by this section, is a matter of negotiation between the lender and the Agency. The maximum percentage of guarantee is 80 percent for loans of $5 million or less, 70 percent for loans between $5 and $10 million, and 60 percent for loans exceeding $10 million." Frequently, the negotiation of the

EXPIRATION DATE:
June 30, 2004

FILING INSTRUCTIONS:
Preceding RD Instruction 4279-B

percentage of guarantee between the lender and the Agency is limited to the lender requesting, and the Agency agreeing to, the maximum percentage of guarantee allowed by section 4279.119(b). There are numerous situations where the Agency approval official should consider less than the maximum percentage of guarantee allowed.

For example, RD Instruction 4279-B, section 4279.181(p), instructs the approval official to consider the increased risk to the Agency when negotiating the percentage of guarantee with the lender on projects where the Loan Note Guarantee is issued for projects other than turnkey operations. Such operations run the risk of cost overruns. Even though the lender must monitor construction, in accordance with section 4279.156(b), cost overruns occur frequently, no matter when the Loan Note Guarantee is issued. The cost overrun must be paid for by someone. Part of the additional risk to the Agency is whether or not the project can succeed with an increased debt service requirement, assuming the lender is willing to make a loan for the cost overruns outside of the guarantee. Alternatively, the principals must have the resources, and be willing, to inject additional cash to cover the cost overruns if the lender is not willing to make an unguaranteed loan. As a last resort, the Agency could consider making a subsequent guaranteed loan at a reduced percentage of guarantee. This would require a new credit analysis by the lender and Agency to ensure that the project cash flows and equity requirements will be met.

Other situations where consideration should be given to reducing the percentage of guarantee include, but are not limited to, debt refinancing loans secured by highly specialized equipment, loans secured by second lien positions, and loans where there is an inordinate risk to the Agency.

If you have any questions, please contact the Business and Industry Division Processing Branch, (202) 690-4103.

(Signed by John Rosso)

JOHN ROSSO
Administrator
Rural Business-Cooperative Service